

Decision 06-02-018 February 16, 2006

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U 902 E) for Adoption of its 2006 Energy Resources Recovery Account (ERRA) Forecast Revenue Requirement and Review of its Power Procurement Balancing Account.

Application 05-10-004
(Filed October 3, 2005)

**OPINION ON 2006 ENERGY RESOURCE
RECOVERY ACCOUNT FORECAST**

1. Summary

This decision adopts a 2006 Energy Resource Recovery Account (ERRA) revenue requirement forecast of \$478 million for San Diego Gas & Electric Company (SDG&E). This forecast represents an increase of \$177 million, or 59% over the 2005 ERRA forecast. The large increase in ERRA revenue requirement is mainly due to fuel costs added to the ERRA¹ for a new generating plant, (the Palomar Energy Center), and the substantial increase in market energy prices. Rather than increase rates by \$177 million, SDG&E is allowed to consolidate into one advice letter filing all its Commission-authorized revenue requirements from

¹ Because the ERRA relates to only one of the specific components of commodity rates, an increase in ERRA costs does not necessarily result in an equivalent increase in rates. Since the ERRA recovers Procurement Costs. Including SDG&E Utility Retained Generation (URG) costs, the balance does not reflect any offset that may occur in Department of Water Resources (DWR) revenue requirements when URG energy displaces the need for energy from DWR resources.

other proceedings currently being addressed by the Commission. This matter is uncontested and the proceeding is closed.

2. Background

Consistent with the objectives of Pub. Util. Code § 454.5(d)(3), the ERRRA was established to track the major energy utilities' fuel and purchased power revenues against actual recorded costs. Pursuant to Decision (D.) 02-10-062 and D.02-12-074, the ERRRA provides full recovery of SDG&E's energy procurement costs associated with fuel and purchased power (including renewable resources), utility retained generation (URG), Independent System Operator (ISO) related costs and costs associated with the residual net short procurement requirements to serve SDG&E's bundled service customers. The ERRRA includes revenues from SDG&E's Electric Energy Commodity Cost (EECC) rate schedule adjusted to exclude Department of Water Resources (DWR) purchases and commodity revenues assigned to the Non-Fuel Generation Balancing Account (NGBA). The ERRRA is considered in semi-annual applications – one to consider forecast issues and the other to consider reasonableness issues.

3. Procedural Summary

SDG&E timely filed this application on October 3, 2005. The application is supported by a redacted and unredacted version of the Direct Testimony of Kenneth J. Deremer and the redacted and unredacted testimony of Michael McClenahan. On December 29, 2005, the assigned administrative law judge (ALJ) issued a ruling granting SDG&E's motion for a protective order regarding the redacted testimony.

No protests to SDG&E's application were filed. By letter dated November 7, 2005, the Division of Ratepayer Advocates informed the ALJ that it had reviewed SDG&E's 2006 forecast revenue requirement and did not take issue

with the application. On November 21, 2005, the ALJ issued a ruling indicating that there was no need for evidentiary hearings. SDG&E filed an opening brief on December 12, 2005, and this matter was submitted for decision.

4. Summary of SDG&E Application

SDG&E requests Commission action on the following issues. First, SDG&E identifies the forecast of its load, the resources available to meet the load, fuel costs, and costs for various energy resources. SDG&E used these forecasts to develop its 2006 ERRA forecast revenue requirement of \$477.8 million. SDG&E asks the Commission to find these forecasts reasonable and to approve SDG&E's proposed 2006 ERRA revenue requirement. Second, SDG&E requests that the Commission approve its proposal that the adopted ERRA revenue requirement be combined with other components of SDG&E's total electric commodity revenue requirement currently being addressed in other proceedings as described in the testimony of witness Deremer.

SDG&E states that based on the current balance in the ERRA, there is no need to adjust rates or to order refunds at this time. Therefore, SDG&E proposes that once the Commission acts on proposals in other proceedings affecting the revenue requirement components of SDG&E's electric commodity rates (Schedule EECC), it will make the appropriate filing to incorporate all the various revenue requirement changes into Schedule EECC rates and, if necessary, request either an increase or decrease in those rates.

5. SDG&E's Resources for 2006

The resources underlying SDG&E's forecasted 2006 ERRA revenue requirement are summarized below.

Palomar Energy Center

The addition of Palomar to the SDG&E resource portfolio in June 2006 represents a substantial change in the makeup of SDG&E-owned generation, which only consisted of the Miramar Energy Facility (Miramar) peaking turbine in 2005. Palomar, a low heat rate combined cycle plant, is expected to be an economic resource for the majority of the hours that it is available, whether its energy is used to serve SDG&E bundled load or is sold into the market.

The 2006 ERRA forecast contains 100% of the fuel costs for the Palomar operation, even in situations where Palomar capacity is used to support economic sales. When Palomar energy is used for economic sales, SDG&E records 100% of the fuel cost as an ERRA expense, but shares a portion of the sales revenue with DWR as set forth in the Operating Agreement. Since the DWR load share is forecasted to average about 48% in 2006, SDG&E will share on average 48% of total sales revenue with DWR. While SDG&E's share of sales revenue, roughly 52%, is recorded in ERRA, the revenue may not be sufficient to offset the full gas expense related to the sale volume. To the extent that the DWR share of sale revenues creates an over collection in the SDG&E-specific DWR balancing account, that over collection will eventually be returned to SDG&E customers by reducing the DWR revenue requirement. In the short term, however, the imbalance can increase the ERRA balance.

When Palomar energy serves SDG&E's bundled load, it will displace other dispatchable generation and market purchases. Such a displacement of DWR dispatchable generation does not produce a corresponding reduction in ERRA expenses since DWR contract costs are not recovered through ERRA. It does, however, reduce the DWR avoidable cost component of the DWR revenue

requirement. When Palomar displaces market purchases, there is an offset in the ERRA balance.

Market Energy Price

SDG&E used a mid-year (July 1, 2005) forecast for gas and electric energy prices for its production cost simulation modeling of 2006 expenses. Even though this forecast did not reflect rapid energy price increases that occurred after Hurricanes Katrina and Rita, they were still about 31% higher than the price forecast used in the 2005 ERRA forecast. Market purchase volumes are lower in 2006 than 2005 due to displacement by Palomar. Even with lower purchase volumes, however, the higher market price forecast accounts for the 25%, or \$17.9 million, increase in ERRA market purchase expenses.

The current market prices, which are even higher than those in the July 1, 2005 price forecast also have an impact on ERRA expenses. As market prices have risen in the second half of 2005, SDG&E has hedged a significant portion of its exposure to 2006 gas prices in response to erosion in remaining Customer Risk Tolerance (CRT). CRT, which is an integral component of SDG&E's hedging plan, measures the amount of price volatility induced energy cost increase that SDG&E customers would be willing to accept. The result of this hedging is to lock in future gas prices to prevent cost-exposure to further price increases.

SDG&E's future ERRA gas cost exposure is primarily related to Palomar fuel costs. A September 20, 2005 price forecast was used as a proxy for generation gas hedged positions in 2006. Relative to the July 1, 2005 gas price forecast, the impact of hedging increases generation gas fuel expenses by \$29 million, which is included in the overall \$129.6 million generation fuel ERRA expense.

QF Contracts

Higher market prices also influence the cost of qualifying facility (QF) contracts. While most large SDG&E QFs are on a Commission-approved five year fixed pricing agreement, the terms of those agreements expire in mid-2006. As those fixed-price agreements expire, SDG&E assumes (for ERRA forecasting purposes) that the contracts will revert to short run avoided cost (SRAC) pricing, which is based on actual gas prices. Since each of the QF contracts that are assumed to revert to SRAC pricing also qualify as Competition Transition Change (CTC) contracts, the impact of high gas prices on QF contracts with SRAC pricing is mostly reflected by an increase in CTC expenses. This is because the ERRA only collects QF expenses up to the CTC market proxy price.

CTC Market Proxy Price

The CTC Market Proxy price is a benchmark for evaluating reasonableness of utility procurement costs. High market prices influence the CTC Market Proxy Price. In this ERRA filing, SDG&E proposes to change its CTC Market Proxy Price from \$53.00/MWh, which is currently in effect, to \$69.50/MWh to match the draft market proxy price determined by the Energy Division as part of Pacific Gas and Electric Company's (PG&E) 2006 ERRA Revenue Requirement proceeding. This increase in the market proxy price has a direct impact on ERRA expenses, since only the costs up to market proxy price on CTC-qualified contracts are recorded in the ERRA. The CTC-qualified contracts in SDG&E's portfolio are Portland General Electric (PGE) and a majority of the QFs. The ERRA expense for "Portland General Electric (up to market)" and "Qualifying Facilities (up to market)" increased by \$33 million solely as a result in the \$16.50/MWh (or 31%) increase in the CTC market proxy price for 2006, since generation volumes are essentially unchanged from 2005.

On December 15, 2005, the Commission issued D.05-12-045 in PG&E's Erra proceeding Application (A.) 05-06-007 directing PG&E to calculate its ongoing CTC in accordance with the "statutory method" described in the decision (Ordering Paragraph 6). D.05-12-045 explains that the statutory method for determining on-going CTC differs from the total portfolio method in that the total portfolio method includes utility retained generation (URG), while the statutory method does not (*see* D.05-12-045, p. 9.)

SDG&E confirms that it used the statutory methodology to determine its forecasted, on-going CTC amount of \$69.038 million above the proposed market proxy of \$69.50/MWh for eligible CTC power purchase contracts. As stated in the Direct Testimony of witness McClenahan, SDG&E's CTC eligible resources are non-URG resources. The CTC-eligible power purchase contracts are PGE Boardman and all QF contracts with the exception of one 14 MW contract. SDG&E states that it applied the calculation of its CTC to purchase power contracts eligible for CTC treatment under the provisions of Assembly Bill (AB) 890 and in accordance with SDG&E's adopted Transition Cost Balancing Account tariff.

New Renewable Contract

SDG&E has a new power purchase contract from a renewable wind resource, Kumeyaay, that goes into effect in 2006. The projected \$8.5 million in contract costs fully accounts for the increase in 2006 Erra costs for "Other Power Purchase Including Renewables."

San Onofre Nuclear Generating Stations (SONGS)

Due to planned refueling outages in 2006 for both SONGS 2 and 3, SDG&E forecasts that SONGS deliveries will be lower in 2006 by 788 GWh or 21%, when compared to 2005. While the Erra fuel costs for SONGS are

relatively constant between 2005 and 2006, SDG&E must replace the lost SONGS generation from the refueling outages with more expensive dispatchable generation or market purchases. Using the CTC market proxy price of \$69.50/MWh, the cost of this replacement energy can be approximated at about \$55 million. Not all of this added expense will be reflected in the ERRA, however, since some of the replacement energy may come from DWR dispatchable generation.

6. Proposed Advice Letter Filing

As stated above, SDG&E does not propose to increase its electric commodity rates by \$177 million as part of this application. Rather, coincident with the approval of the 2006 ERRA and CTC revenue requirements, SDG&E proposes to file an advice letter to combine the revenue requirement impacts from this proceeding with those from other applicable electric commodity proceedings,² including the allocation of the 2006 DWR revenue requirement,³ the non-fuel costs associated with SONGS,⁴ the Miramar and Palomar generation facilities, and any impacts from the disposition of the balance in the Direct Access Responsibility Surcharge Memorandum Account (DACRSMA).

² See direct testimony of Kenneth J. Deremer, p. KJD-4.

³ On December 1, 2005, the Commission issued D.05-12-010, which establishes the allocation of the 2006 DWR revenue requirement.

⁴ Includes impacts from expected refueling outages as well as the revenue requirement adopted in A.04-12-004, Southern California Edison's 2006 General Rate Case.

SDG&E states that as part of this proposed advice letter filing, it will also incorporate the receipt of any electric supplier refunds recorded to the ERRAs⁵ and provide, if necessary, a specific proposal to utilize overcollections in other regulatory accounts to mitigate an electric commodity rate increase. In addition, the advice letter filing will address a reduction to the ongoing CTC rate to reflect the 2006 CTC revenue requirement, approved in this application.⁶

7. Discussion

For purposes of this proceeding, we find SDG&E's resource supply and revenue requirement forecast for 2006 to be reasonable. As set forth in the prepared testimony of witnesses Deremer and McClenahan, SDG&E has provided the necessary showing to support its request. Also, we conclude that SDG&E's proposal to file an advice letter to combine the revenue requirement from this proceeding with other applicable electric commodity proceedings to avoid multiple rate changes, is reasonable and should be adopted. Accordingly, SDG&E's application should be approved without change.

8. Categorization and Need for Hearings

In Resolution ALJ 176-3161 dated October 27, 2005, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received and there is no apparent reason why the application should not be granted. Our

⁵ Settlements with Reliant and Enron have been filed with the FERC, resolving issues relating to the 2000-2001 energy crises. SDG&E currently expects that the receipt of settlement proceeds will occur in early 2006.

⁶ The current adopted CTC revenue requirement is \$116.644 million (\$115.034 million approved in D.03-02-028 plus \$1.610 FF&U). If the pending settlement in A.00-05-002 is adopted, the current CTC revenue requirement will be reduced by \$12.2. million.

examination of the record persuades us that a public hearing is not necessary. Accordingly, we affirm the preliminary determination made in Resolution ALJ 176-3161.

9. Comments on Draft Decision

This is an uncontested matter, in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

10. Assignment of Proceeding

John Bohn is the Assigned Commissioner and Bertram D. Patrick is the assigned ALJ in this proceeding.

Findings of Fact

1. No party protested this application.
2. SDG&E's proposed 2006 CTC market proxy price is \$69.50/MWh.
3. SDG&E's 2006 ERRA forecast revenue requirement is \$477.8 million.
4. SDG&E's 2006 CTC forecast revenue requirement is \$70.0 million.
5. SDG&E proposes to combine in one advice letter filing the adopted ERRA and CTC revenue requirements with other components of SDG&E's total electric commodity revenue requirement currently being addressed in other proceedings.

Conclusions of Law

1. SDG&E's 2006 ERRA revenue requirement forecast as shown in SDG&E's application and supporting testimony, should be adopted.
2. SDG&E's proposal to combine in one advice letter filing the revenue requirement authorized in this proceeding with the revenue requirements authorized in other proceedings currently being addressed by the Commission, should be adopted.

3. An evidentiary hearing is not necessary.

O R D E R

IT IS ORDERED that:

1. San Diego Gas & Electric Company's (SDG&E) 2006 Energy Resource Recovery Account (ERRA) forecast shall be adopted, including: (a) a 2006 ERRA forecast revenue requirement of \$477.8 million; (b) a 2006 Competition Transition Charge (CTC) revenue requirement of \$70.0 million; and, (c) a 2006 CTC market proxy price of \$69.50/MWh.
2. SDG&E's proposal to combine in one advice letter filing the authorized 2006 ERRA and CTC revenue requirements with other authorized revenue requirements currently being addressed in other proceedings, shall be adopted.

3. Application 05-10-004 is closed.

This order is effective today.

Dated February 16, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners